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Written Testimony of

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Finance & Tax Subcommittee Hearing on
"Legislative Proposals to Reform the SBA's Capital Access Programs"

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Thank you Chairman Schrader, Ranking Member Buchanan and members of the Subcommittee for the opportunity to testify on behalf of the Corporation for Enterprise Development (CFED) regarding improvements to the SBA Microloan Program. We would also like to thank Chairwoman Velázquez for her continued leadership on microenterprise. She has demonstrated an ardent commitment to ensure that low-income entrepreneurs are not excluded from accessing capital for their small businesses. Lastly, we would like to thank the Administration for recognizing the economic importance of microenterprise and the SBA Microloan Program.

Microenterprise is a critical component of our nation's economy. According to CFED's Assets and Opportunity Scorecard, there are 24,905,573 microenterprises in the United States in 2006 (most recent Census data); 16.5% of the labor force owns a microenterprise. According to the Federal Reserve, 3% of families in the lowest income quintile own a business asset. Microenterprise is supported at the federal and state level: approximately 33 states provide funding for microenterprise.

CFED, the Corporation for Enterprise Development, is a nonpartisan national nonprofit organization that celebrates our 30th anniversary this year. We collaborate with diverse partners across the field of microenterprise, including the Association for Enterprise Opportunity, the Center for Rural Affairs, Aspen Institute's FIELD program, State Microenterprise Associations such as the Oregon Microenterprise Network, SBA Microloan Intermediaries and other microenterprise practitioners. CFED also chairs the Microenterprise Anti-Poverty Coalition (MAP), and is a leader in promoting the expansion of economic opportunity to include all people. We strongly believe that this will bring greater social equity, alleviate poverty and lead to a more sustainable and inclusive economy.

Our mission is to bring together community practice, public policy and private markets in new and effective ways. We combine the innovation of a think tank with the "on-the-ground" insight of practitioners to:

- Identify ideas that make the economy work for everyone. We focus on communities that have traditionally been excluded from or limited by the mainstream economy. We conduct rigorous research, seeking ideas that have potential for practical application.

- We also work with economic development practitioners to pilot programs and provide funding to design and modify effective strategies to be successful in different cultures, regions and economic conditions.

- Lastly, we develop and advocate for federal and state policies that move the nation toward a more equitable and inclusive economy. We publish reports, convene working groups and provide information to help partners participate in the policymaking process.

Along with homeownership and continuing education, CFED focuses on microenterprise as a key asset-building tool for low-income entrepreneurs. We strongly support the SBA Microloan Program, which provides capital, training and technical assistance to disadvantaged entrepreneurs.

The Microloan Program was first authorized as a demonstration program in 1991, with the goal of reaching microentrepreneurs that were being served neither by mainstream financial institutions nor SBA's credit programs. Research and reporting by the Aspen Institute shows that approximately 10 million microentrepreneurs experience difficulty accessing capital from traditional lenders, and that half of these entrepreneurs are women.

Our current economic realities are undoubtedly pushing these numbers even higher, as job losses, tight credit markets and stringent readings of consumer credit reports make accessing business capital all the more difficult. Low-income entrepreneurs, minorities and women especially experience difficulty in obtaining business financing; even when they are highly skilled service workers, they do not have the business experience or training to make them mainstream credit-worthy.

The ultimate goal of the SBA Microloan Program is to provide resources for entrepreneurs who are ready to go from business curious to business capable, move into the financial mainstream and create jobs. A study of 25 microenterprise programs by the Aspen Institute found that the number of jobs (not including the owner) at the businesses assisted more than doubled after these businesses received microenterprise services.

Despite historically strong bipartisan support in Congress, the Microloan Program suffered years of neglect under the previous Administration. During this time, the program was continually targeted for elimination, severely understaffed, had no Standard Operating Procedure, did not collect or report on outcomes-based data and made public very limited information. In addition, funding was cut so severely that as early as 2003, the SBA Office of the Inspector General noted that these cuts made it nearly impossible to expand the field of Microloan Intermediaries.

We very much look forward to working with the Subcommittee and the Administration to improve this important program, and ensure that it reaches its full potential. We believe that the draft legislation under discussion today provides an excellent start to this discussion. Many of the reforms contained in today's draft bill have been requested for years by Microloan Intermediaries. It is our hope that these provisions will provide a long overdue update to the Microloan Program.

First, we are pleased to see that the Subcommittee has included language that allows Microloan Intermediaries to offer more flexible credit terms to entrepreneurs. This will allow Intermediaries to develop responsible financial products that meet the specific needs of their borrowers. This is especially true for entrepreneurs that provide seasonal services, and those whose business needs fluctuate according to other markers. For example, a home air conditioning repair service will typically experience a spike in demand during the hot summer months and might request a small revolving line of credit that would meet their cash flow needs more adequately than a three-year loan. Ultimately, our goal is for these entrepreneurs to benefit from responsible innovations in microlending.

Second, we agree with the Subcommittee and the Administration that increased program participation is necessary to meet the needs of underserved low-income entrepreneurs. We welcome language that expands eligibility requirements for prospective Microloan Intermediaries. We agree that SBA should have discretion to determine the type of experience necessary to become an Intermediary.

Third, we are pleased to see that the Subcommittee recommends increasing the cap on borrowing by Intermediaries, and increasing the maximum loan size of an SBA Microloan. Many of the highest-performing, most capable Intermediaries in the Microloan Program have met their loan limit, and are unable to make additional Microloans despite heavy demand. Increasing the cap from $3.5 million to $7 million will provide a much-needed injection of capital for these Intermediaries. We suggest that SBA be given the option to increase the cap further, to $10 million, for Intermediaries that meet certain criteria to be determined by SBA. We are also pleased to see an increase in the maximum loan that an Intermediary can make to a borrower, from $35,000 to $50,000. While the majority of Microloans are very small, and the average Microloan hovers around $13,000, this increase reflects a key market reality: the investor return on a $50,000 loan is deemed too small for most mainstream financial institutions. We believe that this change will enhance an Intermediary's ability to meet the capital needs of qualified microborrowers.

Lastly, we are happy to see that the Subcommittee proposes an increase in the percentage of technical assistance grants that may be used for providing information and technical assistance to prospective borrowers, as well as the increase in percentage that Microloan Intermediaries can use for third-party technical assistance.

We also recommend that the Subcommittee consider more extensive changes to the Microloan Program in the near future. After years of neglect, it is possible that further reforms may need to be implemented to optimize program performance. We suggest the following revisions:

- Lowering the loan loss reserve requirement: the required 15% loan loss reserve fund that Intermediaries must maintain results in unnecessary levels of passive capital. The SBA Microloan Program has made loans that no bank would dare take on, and yet has the lowest default rate of any SBA lending program, even as it operates without a guarantee. In fact, for FY 2009, the Microloan program is projected to have a default rate (net of recoveries) of 0.37 percent. Contrast that with the assumption for 7(a) at 3.42 %, or the CDC program at 1.79 %. While SBA regulations allow this requirement to be lowered to 10%, we are dismayed that this is the only SBA lending program that requires a loan loss reserve fund. This limitation forces the SBA to lower its risk on its best-performing program, even while it provides guarantees of 80% and higher through its other loan programs. Data collected by the Aspen Institute on 37 microenterprise lenders showed that in 2007, the median loan loss rate was 3.6%. The average loan loss rate was 5.8%, and only three of the 37 lenders had loss rates above 10%.

- Allowing for the one-time use of SBA Microloan loan dollars for Microloan Intermediary capital improvement projects: the market crash and recession have created an untenable environment for accessing capital. Many Intermediaries find themselves with rising demand and the need to expand or improve facilities to meet the demand. Enabling Intermediaries to borrow loan funds to improve their own facilities creates jobs and strengthens the economy at this time without any loss in access to funding for entrepreneurs.

- Expansion of operations: the advent of highly capable, highly successful microlenders in the United States leads us to ask the SBA and the Subcommittee to study closely whether it is time to eliminate the requirement that Intermediaries not be allowed to operate in more than one state. To this end, we believe that the Microloan Program can balance economies of scale with a sharp focus on community training and technical assistance needs. In fact, some microlenders already operate in more than one state, but this restriction means that they must use their Microloan dollars in some or part of the regions they serve. Permitting multi-state use of Microloan dollars will facilitate regional economic development, something that is much needed in many parts of the nation.

- SBA reporting requirements: unfortunately, very little information is available on the Microloan Program. This drought of data makes it difficult for the microenterprise field to focus on areas of improvement and efficiency. We would ideally like to see yearly SBA reporting requirements, include such information as individual loans made and loan dollar volume per Intermediary, as well as other key information such as credit score and jobs created related to borrower success.

I would like to thank the Subcommittee once again for the opportunity to testify today. CFED looks forward to partnering with Congress and the Administration to enable low-income entrepreneurs to start and grow businesses to achieve financial self reliance in vibrant communities. I look forward to answering any questions that you may have.

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